The Audit Committee of Listed Companies under the Kuwait Corporate Governance Code (KCGC): A Legal Comparative Study(*)

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Abstract

One of the most important corporate governance principles is the establishment of various committees to secure the company's financial position and long-term future. In Kuwait, the legal position regarding the Audit Committee is currently unclear. In view of the fact that there are not sufficient regulations in Kuwait regarding the audit committee, this paper reviews the current position and makes recommendations with a view to improving this situation.

The article will discuss the concept of the Audit Committee in general, what its purpose is, as well as the duties and responsibilities of the committee. In doing so, the paper will highlight areas of concern relating to the current legislation in Kuwait.

Furthermore, the paper aims to provide recommendations for the development of regulations relating to audit committees of listed companies on the Kuwaiti stock exchange. The article will consider the legal position in the USA, in particular the how the laws and regulations relating to the Audit Committee are applied for companies listed on the NYSE. The research will follow the process of a comparative legal analysis between USA legislation and Kuwait legislation.

Keywords: Corporate Governance, Kuwaiti Stock Exchange, Board of directors.

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1. Introduction

Corporate Governance Principles aim to improve the way in which companies are managed by the board of directors. By following these principles, companies can ensure that proper processes are followed that will lead to the success of the business. By establishing various committees such as the Audit Committee, the Risk Management committee and / or the Remuneration Committee, the board of directors can ensure that businesses strengthen the listed company's long-term future(1). It is common practice for boards of directors to establish various committees to carry out some of its roles and responsibilities.

However, the legal position regarding the Audit Committee in Kuwait is unclear. The ambiguity of the legal position leaves many questions unanswered, such as: Who should be appointed to this committee? What are the committee's responsibilities? What is the committee's standing in relation to the board of directors? This article will aim to address these questions and provide suggestions on how the legal position in Kuwait could be improved by examining how the Audit Committee is regulated in the United States, and in particular, the NYSE.

In Kuwait, the enactment of corporate governance rules has created a number of new ideas, such as the establishment of committees, the independence of directors, the separation of CEO from the chairman, having an internal audit system, and other related principles. This article focuses on the principle of establishing an audit committee.

1.1. Aims of the Article

Corporate governance is a recent development in Kuwaiti financial markets. The government of Kuwait enacted a series of corporate governance codes between 2013 and 2015. The main aim of this research article is to present a detailed understanding of the Kuwait Corporate Governance Code (KCGC) as it relates to having an audit committee. The focus is on whether the Code offers an appropriate framework and, if applicable, suggest amendments thereto. This research will firstly highlight the weaknesses of the KCGC

(1) In fact, the existence of insider control problems can be explained by the conflict of interest between the principal (owner) and the agent (manager). This article has not attempted to discuss the various theories related to corporate governance, such as the agency theory. There are various theories about what corporate governance means, but the predominant theory is the 'agency theory', which considers the shareholders to be the principals and the directors to be their agents. Thus, there is a separation of ownership and control. Christine Mallin, *Corporate Governance*, 4th ed. (2013), pp.16–18.

in terms of establishing an audit committee in order to improve the Code. Secondly, the original research will be of interest and benefit to scholars, policy-makers, government officials, law enforcement, and others with an interest in governance in Kuwait.

1.2. Methodology of the Article

This article compares Kuwaiti legislation with that of the developed market in the United States of America (USA) to evaluate its potential effectiveness in averting problems and bringing a better understanding of this subject to Kuwaiti scholars and business people. The USA has legislation to ensure that firms have audit committees. This legislation has evolved over many years in an effort to increase the efficacy of corporate governance. As a result, the use of a comparative law approach in this article helps to determine which laws and regulations have the greatest value.

This article explores in great detail the existing legal frameworks applicable to the KCGC and to analyze the more controversial subject of having an audit committee. It also has a comparative analysis of corporate governance systems within the USA and Kuwait to gain insight into the Kuwaiti system and to propose recommendations accordingly.

1.3. Structure of the Article

In discussing the establishment of audit committees in Kuwait, this paper compares the provisions of corporate governance of the New York Stock Exchange (NYSE) and those of the Kuwait Stock Exchange (KSE). This article is underpinned by a comparative legal analysis of the NYSE relating to corporate governance in an effort to improve the Kuwait Corporate Governance Code 2015 (KCGC).

The paper is divided into three sections. The first section discusses the definition of an audit committee. Section two considers the current approach in the KSE toward this subject. Section three provides a comparison with the New York Stock Exchange (NYSE), with a view to making recommendations for the KSE.

2. What Is an Audit Committee?

An audit committee is one of the various committees established by the board of directors of a company(2). The committee is composed of a group of board

(2) Boards of directors have ongoing challenges related to the governance of their companies, the risks associated with achieving their companies' objectives, and compliance with revised and emerging laws and regulations. American Institute of Certified Public Accountants, The AICPA Audit Committee Toolkit: Public Companies, (2014), p.3.

members specifically chosen to sit on the audit committee which is responsible for the oversight of the internal auditing process, as well as the external auditing of the company's financial documents. In addition, the committee has the responsibility of overseeing the financial reporting of the company, oversight of the independent directors, oversight of risk management as well as oversight of ethics and compliance within the company.

It is common practice for boards of directors to establish various committees to carry out some of the board's roles and responsibilities. The audit committee is one of the more important of these. Setting up such committees is recognized as good corporate governance practice. Audit committees are made up of a number of directors and this number differs from country to country. By implementing an internal audit function (IAF) companies will improve their corporate governance and the overall performance of the company(3).

Good corporate governance practices dictate that some of the audit committee members should be independent directors and that their independence should be continuously maintained and reviewed. Although there is no established definition of an independent director, it can be said that an independent director is a person who holds the position of director on the board of a company but has no affiliation or relation with the company that could affect his or her independence(4). The benefit of having an independent director on the audit committee is that he is free from any board pressure. The result should be that decisions made by the committee are in the best interests of the company and in line with the best practices in the industry.

The requirements for independent board members differ from country to country and much depends on each country's rules of corporate governance. For instance, for a company listed on the NYSE, no member of a board qualifies as independent unless the board of directors' relationship can be direct or indirect. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships, among others. However, as the concern is for independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding(5). This material relationship can

(3) Mihret Dessalegn Getie & Grant Bligh, *The Role of Internal Auditing in Corporate Governance: A Foucauldian Analysis,* 30 Accounting, Auditing & Accountability Journal 3, (2017), p.740.

(4) Bob Tricker, *Corporate Governance: Principles, Policies, and Practice*, 3d ed., Oxford University Press, 2015, p.93.

(5) New York Stock Exchange, *Listed Company Manual*, https://www.ghco.com/static-files/60538d32-b4e0-481e-801c-2df74b4163c6 (last visited October 7, 2021).

be with the firm directly or indirectly. Examples of an indirect relationship are a) a partner; b) a shareholder; and c) an officer with other companies having a material relationship with the listed company. Some stock exchanges require that a member of the audit committee be someone who can be considered a "financial expert." Due to the nature of their responsibilities, these members are required to review critical accounting policies, practices, judgments, estimates, and other significant issues.

Audit committee roles can differ from company to company due to factors such as the size of the company and its activities. Audit committees assist the board with different functions, such as the integrity of the firm's financial statements, internal controls, independent auditor's qualifications, internal audit function, the company's risk management and overall governance process, and the company's ethics and compliance[6].

In general, the audit committee is responsible for oversight of the financial reporting process, of the financial reporting, of the independent auditor, of the internal audit function, of risk management, ethics, and compliance. It is important to mention that the audit committee also has the responsibility to see that the above objectives are achieved. It is not responsible for planning or conducting routine audits or being the primary determinant that the company's financial statements and disclosures are complete and accurate[7].

Most listed companies have an audit committee charter established by the board of directors, which sets out the committee's purpose, mission, authority, policies and procedures, and other terms of operation. It is considered to be the best practice to review this charter annually, which is done in a majority of listed companies in developed markets. One of the main aims of the audit committee is to detect, prevent, and deter fraud within the company. However, fraud is a wide-ranging topic that can include financial statement fraud, corruption, and asset misappropriation. Fraud can be committed by executives, managers, employees, and other individuals not working within the company. Thus, it is vitally important that the audit committee is assisted in the discovery of fraud, the investigation of fraud, and the reporting of its findings to the board.

Generally, the audit committee will meet at least once per quarter to review the financial documents as prepared by the internal auditor. It will also review other pertinent matters before submitting a report to the board of directors. This report, or aspects of it, can be included in the annual financial reports of

(6) American Institute of Certified Public Accountants, *supra* note 2, at 4.

(7) *Id*. at 6.

the company. In addition, the committee usually meets once the external audit of the company has been completed as well as at any other time that it needs to discuss matters relating to its roles and responsibilities.

3. The Audit Committee in Kuwait

This section discusses the audit committee in Kuwait in greater detail and focuses on three main concepts, namely the purpose of the committee, the main features of the committee, and the consequences of non-compliance with recommendations of the audit committee.

In the Kuwaiti Code of 2015, there are only three articles that refer to an audit committee. These articles are 5.5, 5.6, and 5.7. According to article 5.5, the main aim of establishing an audit committee is to ensure the soundness and integrity of financial reporting(8) and internal audit systems. An audit refers to the process of inspecting financial reports, and the internal audit systems are established with a view to ensuring the integrity and soundness of these reports.

The form of an audit committee should: 1. always be consistent with the nature of the company's activities; 2. always have full independence(9), and 3. include personnel with the relevant specialized experience to ensure compliance with the internal audit system. Therefore, audit committees should be independent, have specialized personnel, and take into account the nature of the company's activities.

In Kuwait, it is compulsory for companies to set up audit committees(10). The KCGC states:

> Except for the principle (Comply or Explain), the following principles shall be complied with: Rule V (Apply Sound Systems of Risk Management and Internal Audit): Article

(8) Whilst the definitions of terms such as «soundness and integrity» of financial statements are outside of the scope of this work, in general they refer to trustworthy and reliable financial documents that can be used with confidence. Integrity is adherence to moral and ethical principles. Soundness is being financially strong, secure, and reliable.

(9) The term «Independence» in relation to the audit committee refers to the committee not being subjected to or under any under the influence by of management or shareholders or any other parties that may be affected by the committee's recommendations.

(10) Article 1-2 of Kuwaiti Code 2015, which states that "Pursuant to the Comply and Explain principle, as referred to in Article 1-1 hereof, the following rules shall be subject to commitment and compliance:…. Rule V: Apply Sound Systems of Risk Management and Internal Audit….The company must comply with implementing the previous rules. In case of noncompliance, the company shall be subject to Penalties as stated in Law and these Bylaws".

(5-5) of this Module: The Board of Directors shall form an Audit Committee to ensure Soundness and Integrity of Financial Reporting and Internal Audit Systems…. companies shall implement the aforementioned rules. Noncompliance with these rules shall expose the company to the penalties set forth in the Law and these Bylaws.

3.1 Members of the Audit Committee

This section will focus on the relevant provisions relating to the Members of the Committee[11], the Powers and Responsibilities of the Committee, and the Audit Committee meetings.

Parts 1, 2, and 3 of Article 5.6 set out the number of committee members that are required. The members of the audit committee are appointed from the board of directors. The committee requires at least three members, and it is preferable if one of the members is an independent director[12]. In addition, the committee must have at least one member with educational qualifications and/or practical experience in accounting or finance.

In Kuwait, the introduction of the independent director system has led to much debate. For example, the Kuwait Chamber of Commerce & Industry (KCCI) criticized the KCGC by saying that in a country of 1.3 million people, of whom fewer than 700,000 are over the age of 20, an independent director would in all likelihood be either a newly-graduated young man who had not yet acquired any experience or someone who has been retired for more than two years and who has few family members and relatives.

Furthermore, enacting legislation that requires an independent director be added to the board could create an impression that the other board members

(11) Article 5.6 of Kuwaiti Code 2015.

(12) The KCGC lists certain criteria for independent directors. These include attributes that directors must have and specified things that should be avoided. Firstly, the KCGC sets a general standard for determining the independence of a director. Unlike the NYSE that uses the «material relationship» test, the KCGC provides a number of examples and situations that disqualify a person from serving as an independent director. As a result, if any of these situations exist, the director will not be considered an independent member. Secondly, the following is required for a director to be classified as an independent director:
1) appropriate qualifications;
2) high level experience; and
3) technical skills that are consistent with the company's activity.
The independent director may be entrusted with advisory duties relating to the company›s various activities. The company must ensure that the independent director is free from any restrictions or pressures when carrying out his duties. Article 2-3 of Rule I "Construct a Balanced Board Composition" in The Executive Bylaws related to Corporate Governance 2015.

are not trusted or seen to be "independent," competent, or sufficiently impartial to act in the best interests of the shareholders.

In Kuwait, an independent board member must be elected by the general assembly of the company, which is comprised of the owners of the company. This fact alone renders the term "independent director" an empty title, rather than having any special meaning. The concept of "independence of decision and thought" is primarily an ethical and fundamental issue. Freedom from the pressure of kinship, politics, tribe, or sect requires that the director be courageous and have a good moral character(13). According to KSE rules, the board has no responsibility to determine the independence of a director. This makes the determination process more complex(14).

The board chairman or executive members of a board of directors cannot be members of the audit committee. The audit committee is entitled to outsource external expertise, subject to the approval of the board of directors. The board can also specify the membership term of the committee members and the mechanisms of its operation.

An effective audit committee can be achieved by having qualified members with the power and resources to protect stakeholder interests by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight tasks(15). Article 5.7 outlines the power and responsibilities of the audit committee and is examined below.

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(13) (Kuwait Chamber of Commerce and Industry, *Home Page*, https//:kuwaitchamber.org.kw/echamber/website/index. (last visited October 7, 2021)

(14) In Kuwait, according to Rule I of the KCGC 2015, "Construct a Balanced Board Composition," the following cases are examples of obstacles to the director being considered independent., This list is not exhaustive.
- Holding Company Shares: In Kuwait, the independent member shall not hold 5% or more of the company shares for which he is nominated or represented.
- Family Relations: An independent director shall not have a first-degree family relationship with any of the members of a board of directors or executive management members in the company or any other company in its group or the relevant main parties.
- Company Group: An independent director shall not be a member of another board of directors in the same group of companies.
- Employment: An independent director shall not be an employee of the company or any company in the same group or be employed by any of the stakeholders. An independent member shall not be an employee of corporate entities who own controlling shares in the company.

(15) F. Todd DeZoort and Dana R. Hermanson and Deborah S. Archambeault and Scott A. Reed, Audit Committee Effectiveness: A Synthesis of the Empirical Audit Committee Literature, KPMG Audit Committee Institute, 21 *Journal of Accounting Literature,* (2002) pp38-41.

3.2 Powers and Responsibilities

The audit committee is required to submit a report to the board of directors giving the committee's opinion and recommendations on the company's financial statements. In order to do this, it is required to review them to ensure that they are accurate and transparent(16). The audit committee also has to provide its opinion and recommendations to the board on the accounting policies applied(17). It also has to verify the company's compliance with related rules, policies, and regulations(18). In addition, it has to evaluate the outcomes of regulatory bodies' reports and ensure that necessary measures were taken in this regard(19).

- **Evaluating Task**

The committee evaluates the efficiency of internal audit systems currently in place and prepares a report including its opinion and recommendations(20). One of the most important functions of the audit committee is to evaluate the internal auditing systems. In order to provide the board of directors with accurate information, these internal auditing systems need to be monitored and evaluated on a regular basis.

The audit committee will then prepare a report on these systems and make recommendations for improving them, which will be submitted to the board for approval. The term internal audit function does not mean that every aspect of the business needs to be audited(21). Nowadays the internal audit function is more important to society(22).

- **Supervising Task**

One of the most important functions of the audit committee is to supervise the company's internal audit department in order to ensure its effectiveness in performing the operations and tasks assigned by the board of directors(23).

(16) Part 1 of Article 5.7 of Kuwaiti Code 2015.

(17) Part 5 of Article 5.7 of Kuwaiti Code 2015.

(18) Part 12 of Article 5.7 of Kuwaiti Code 2015.

(19) Part 11 of Article 5.7 of Kuwaiti Code 2015.

(20) Part 6 of Article 5.7 of Kuwaiti Code 2015.

(21) Lourens Erasmus & Philna Coetzee, *Drivers of Stakeholders' View of Internal Audit Effectiveness: Management Versus Audit Committee: Management Versus Audit Committee,* Managerial Auditing Journal, Volume 33, Issue 1, (2018), p.90.

(22) Mark Martinelli, *Internal Auditing: Trends and Challenge,* CPA Journal Volume 89, Issue 6, (2019), p.8.

(23) Part 7 of Article 5.7 of Kuwaiti Code 2015.

It does this by regularly reviewing the work of the internal audit department identifying ways to improve the accuracy of the accounting/financial reporting. In addition, it assists the department to overcome any obstacles it may encounter, especially with the internal audit systems.

- **Appointing the Internal Audit Manager**

The committee recommends the appointment of an internal audit manager and his removal in addition to evaluating his performance and the performance of the internal audit department[24]. Performance reviews are usually scheduled every year to six months and are conducted by evaluating the work of the internal auditor, as well as, by conducting interviews with other members of the board and staff who interact with the internal auditor.

- **Approving and Reviewing Task**

The audit committee has to review and approve audit plans proposed by the internal auditor and provide feedback[25]. Working together with the audit committee is essential for the internal auditor to reach an appropriate decision on the audit plans. With this cooperation, giving feedback to the board is made easier.

- **Reviewing Internal Audit Reports**

The committee has to review the results of the internal audit reports and ensure that the necessary corrective actions are taken concerning the observations stated in the reports[26].

3.3 The Audit Committee Meeting

Parts 6 and 7 of Article 5.6 of the Kuwait Code set out the details of the number of meetings that must be held by the audit committee. The following meetings are required by the Code: 1) The audit committee is required to meet at least four times per year, or quarterly. Minutes of these meetings must be kept. 2) Meetings with external auditors have to be held periodically. 3) Meetings with internal auditors have to be held at least four times per year. 4) In some cases when their work so requires, the internal auditor and/or external auditor are entitled to request a meeting with the committee without the presence of the executive management.

(24) Part 8 of Article 5.7 of Kuwaiti Code 2015.

(25) Part 9 of Article 5.7 of Kuwaiti Code 2015.

(26) Part 10 of Article 5.7 of Kuwaiti Code 2015.

The relationship between an internal audit system and the audit committee includes various activities such as meetings between the audit committee and the chief audit executive (CAE), the review of policy and the results of the internal audit by the audit committee, the involvement of the audit committee in decisions concerning the appointment and dismissal of the chief audit executive, and the review of the relationship between the internal audit system and management[(27)].

The corporate governance requirements in the USA are similar, except that the meeting between the internal and external auditors can be held without the executive management being present. This allows for open and honest communication of relevant information needed for the audit process. In fact, audit committees in the USA should meet separately with the internal auditor, external auditor, and management. Whilst this is, in theory, a good way to improve the openness of communication about the audit process, it can be time-consuming and costly and is, therefore, not a viable option for Kuwaiti companies.

3.3 Relationship with external auditors

The audit committee deals with external auditors in different aspects of its work, most notably in appointing the external auditors, reviewing their work, as well as implementing recommendations made by them. The audit committee plays a role in appointing external auditors by providing the board of directors with its recommendations concerning their appointment, re-appointment, or replacement, and specifying their remunerations.

It is important that the audit committee ensures the independence of the external auditors and periodically reviews their letters of appointment[(28)]. The audit committee also reviews the work of external auditors. It has to ensure no services other than those related to audit functions are provided to the company by an external auditor[(29)]. Another important function of the audit committee is studying the remarks of the external auditor in relation to the company's financial statements and ensuring that measures are taken to comply with these[(30)].

(27) Imen Khelil et al., *Audit Committee - Internal Audit Interaction and Moral Courage*, 31 Manag. Audit. J, 4/5, 403, (2016), p.438.

(28) Part 2 of Article 5.7 of Kuwaiti Code 2015.

(29) Part 3 of Article 5.7 of Kuwaiti Code 2015.

(30) Part 4 of Article 5.7 of Kuwaiti Code 2015.

Having both internal auditors and an audit committee are essential corporate governance tools that lead to improved financial transparency and investor protection[(31)].

3.4 Noncompliance with the Audit Committee Recommendations

Parts 4 and 5 of Article 5.6 set out the requirements for situations where the board of directors chooses not to follow the recommendations of the audit committee. The board of directors must include a statement detailing clearly such recommendations and reasons for noncompliance in the governance report. This includes any conflicts between the recommendations of the audit committee and the resolutions of the board of directors, including the refusal by the board to follow the committees recommendations as it relates to external auditors and/or internal auditors. The Code gives the audit committee the power to consult an independent consulting entity at the company's expense about any situations such as those set out above.

4. The Audit Committee in the USA

With a view to comparing the differences between audit committees in Kuwait and the USA, this section will follow a similar pattern to the one above. It is divided into the following sections: 1) the purpose of the audit committee, 2) the main features of the audit committee including the members and powers of the audit committee as well as the audit committee. However, an additional section will be added to discuss the Written Charter that is required of companies listed on the NYSE[(32)] meeting. in the USA.

The authority vested in the audit committee in the USA is derived from the board of directors, federal law, and exchange listing requirements[(33)]. A good example of federal law that deals with the powers of an audit committee is the Sarbanes-Oxley Act (2002). In terms of this Act, a listed company must have an audit committee that is directly responsible for the appointment, compensation, and oversight of the work of the external auditor[(34)]. In addition, audit committees of companies listed on the NYSE are subject to SEC rules

(31) Imen Khelil et al., *Audit Committee - Internal Audit Interaction and Moral Courage,* 31 Managerial Auditing Journal, Volume 31, Issues 4/5, (2016), pp.403-438.

(32) Of the 13 stock exchanges in the US, the New York Stock Exchange (NYSE) is the most significant for the current topic under discussion. This article, therefore, focuses on the NYSE rules as an example of US legislation in terms of audit committee function.

(33) DeZoort et al. *supra* note 13, th at 44.

(34) Karim Khondkar, Robin Ashok & Suh Sang Hyun, *Board Structure and Audit Committee Monitoring: Effects of Audit Committee Monitoring Incentives and Board Entrenchment on Audit Fees,* 31 Journal of Accounting, Auditing & Finance, Volume 31, Issue 2, (2016), pp.249-250.

and laws, including the listing rules of the NYSE. This article focuses mainly on these audit committees and the rules and laws applicable to them.

4.1 Purpose of the Audit Committee

Initially, audit committees in the USA had very limited powers, essentially confined to the nomination of the external auditor and to set certain parameters for the auditor's engagement. Today, its responsibilities have been expanded to cover a number of roles(35).

4.2 Main Features of the Audit Committee

This section will focus on the relevant rules and laws relating to the Members of the Committee, the Powers and Responsibilities of the Committee, and the Audit Committee meeting.

4.2.1 Members of the audit committee

A properly constituted audit committee(36) must contain a minimum of three members. One of the members should be an independent director. It should be remembered however that each stock exchange in the US has its own definition of independence(37). In addition, at least one member of the audit committee must have accounting or related financial management expertise.

In general, a director or a member of a board of directors can be described as an independent director(38) if he or she does not have a "material or financial relationship" with the company or related persons. Having independent directors has a number of advantages. They assist the company in achieving a balance of power between the various stakeholders and interests in the company. In addition, having independent directors increases the quality of board oversight and reduces the possibility of damaging conflicts of interest(39).

In reality, the process of determining the independence of a director is extremely important to the concept of independent directors. The most important part of the independence test relates to who is responsible for determining whether

(35) Falko Bohm et al., *Audit Committee Charter Scope: Determinants and Effects on Audit Committee Effort,* Int. J. Audit, Volume 20, Issue 2, (2016), p.119.

(36) Section 3 Corporate Responsibility, 303A.00 Corporate Governance Standards, 303A.07 Audit Committee Additional Requirements (a) The audit committee must have a minimum of three members. All audit committee members must satisfy the requirements for independence set out in Section 303A.02 and, in the absence of an applicable exemption.

(37) DeZoort et al. supra note 13 at 43.

(38) Known as an outside director.

(39) Section 303A.01 Corporate Governance Standards, NYSE.

a director is independent. In Kuwait, there is no such rule, which makes the determination process more complex. According to NYSE rules, one of the board's responsibilities is to determine who is independent, and who is not. The NYSE standard states that:

> No director qualifies as 'independent' unless the board of directors affirmatively determines that the director has 'no material relationship' with the listed company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company.

Therefore, boards on the NYSE are left to their own devices to determine who is independent. The test of independence comes down to three words: "no material relationship"(40).

4.2.2 The Powers and Responsibilities of the Audit Committee

The duties and responsibilities of the audit committee include the following:

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(40) In the NYSE, a director cannot be considered an independent member if one of the following conditions exists:

(a) Employment: The director, or a family member, has been an employee of the listed firm during the previous three disqualification from being an independent director. If an immediate family member has been an executive officer of the listed company during the previous three years, then the director will similarly not qualify as independent.

- Receiving Compensation: If the director or an immediate family member has received more than \$120,000 in direct compensation from the company in any twelve-month period during the preceding three years, the director will not qualify as independent. This amount excludes any payments received by the director, committee fees, and pension or other forms of deferred compensation for prior service.

(b) Partner or Audit Relationship: A person is disqualified from serving as an independent director in the following circumstances:

1- If the person is a current partner or employee of a firm that is the listed company's internal or external auditor;
2- If the person has an immediate family member who is a current partner of such a firm;
3- If the person has an immediate family member who is a current employee of such a firm and personally works on the listed company's audit; or
4- If the person or an immediate family member was during the previous three years a partner or employee of such a firm and personally worked on the listed company's audit during that time.

(c) Executive Officers: If, during the preceding three years, the director or an immediate family member was employed as an executive officer of a company and the listed company's present executive officers served on the compensation committee at the same time as the "independent director," the director will be disqualified from serving as an independent director.

(d) Payments: A person is disqualified from serving as an independent director if the director is a current employee, or an immediate family member is a current executive officer of a company that has made payments to, or received payments from, the listed company for property or services in an amount which, during any of the last three fiscal years, exceeded the greater of \$1 million or 2% of such other company's consolidated gross revenues.

- **Evaluate the auditor**

The audit committee must review the report of the external auditor(41) on the company's financial statements and any recommendations made therein. This auditors report describes the company's internal quality control procedures and material issues raised by the most recent internal quality control review or peer review of the company, or issues raised by any inquiry or investigation by governmental or professional authorities within the preceding five years.

The audit committee should review the independence of the external auditor to ensure that all relationships between the auditor and the listed company are truly separated. Furthermore, the committee must review and evaluate the external auditor's work for the preceding year. In addition, the committee should evaluate the auditor's qualifications, performance, and independence. Once this process has been completed, the audit committee should present its findings to the board of directors.

- **Discuss financial statements**

The audit committee has to meet in order to review and discuss the listed company's annual audited financial statements and quarterly financial statements with the board and the independent auditor(42). The details of this meeting will be discussed in greater detail in section 4.2.3 below.

- **Discuss earnings press releases**

The audit committee is responsible for discussing the listed company's earnings press releases, which are the financial information and earnings guidance provided to analyst and rating agencies. The audit committee need not discuss in advance each earnings release or each instance in which a listed company may provide earnings guidance(43).

- **Discuss policies with respect to risk assessment and risk management**

The audit committee must discuss guidelines and policies that govern the process by which risk assessment and risk management are handled and assess and manage the listed company's exposure to risk. This includes major financial risk exposure, and the steps management has taken to monitor and control such exposure.

(41) Rule 10A of Exchange Act 1934.

(42) Section 3 Corporate Responsibility, 303A.00 Corporate Governance Standards, 303A.07 Audit Committee Additional Requirements (b) (iii) (B).

(43) Id. (b) (iii) (C)

The audit committee is not required to be the sole body responsible for risk assessment and management. The CEO and senior management are also responsible. The committee must discuss guidelines and policies to govern the process by which risk assessment and management are undertaken(44).

- **Regularly review any difficulties and audit problems with the independent auditor**

The review should include(45):

- Any difficulties the auditor has encountered with its work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management to be reviewed by the audit committee with the independent auditor.
- Any accounting adjustments that were noted or proposed by the auditor.
- Any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any "management" or "internal control" letters issued or proposed to be issued by the audit firm to the listed company.
- Discussion of responsibilities, budget, and staffing of the listed company's internal audit function.

- **Set clear hiring policies for employees or former employees of the independent auditor**

The audit committee should consider very carefully the hiring of employees or former employees of the external auditors as this has the potential to create many challenges for the company. Whilst these individuals are often valuable additions to corporate management due to their familiarity with the business and accounting procedures of the listed company, the audit committee should bear in mind the pressures that exist for auditors who potentially seek employment with the listed company they audit(46).

- **Report regularly to the board of directors**

The audit committee should report on and review with the full board the following matters:

(44) *Id.* (b) (iii) (D).

(45) *Id.* (b) (iii) (F).

(46) *Id.* (b) (iii) (G).

- Any issues that arise with respect to the quality or integrity of the listed company's financial statements.
- Compliance with legal or regulatory requirements.
- Performance and independence of the listed company's independent auditors.
- The performance of the internal audit function[47].

4.2.3 The audit committee meeting

The audit committee should hold several meetings with various departments to carry out its mandate. Having separate meetings with management, the independent auditors, and those responsible for the internal audit function is essential for the audit committee to gather all the relevant information it needs to compile reports and review activities, as discussed above.

It is more practical to have separate meetings with various parties as this enables the airing of issues that warrant committee attention. These meetings should be periodically scheduled with management, internal auditors, and independent auditors[48].

4.3 The Written Charter

Listed companies on the NYSE must have a written charter setting out the details pertaining to the audit committee[49]. The charter has to include: 1. the committee's purpose[50]; 2. an annual performance evaluation of the audit committee; and 3. the duties and responsibilities of the audit committee. This charter must be made available on or through the company website. Unlike in the USA, the Kuwaiti Corporate Governance Code does not require such a written charter.

It would be an advantage to Kuwait if the Code could be amended to include provisions similar to those in the NYSE relating to a Written Charter. This requirement would mean that audit committees would have to put down

(47) *Id.* (b) (iii) (H).

(48) *Id.* (b) (iii) (E).

(49) Section 3 Corporate Responsibility, 303A.00 Corporate Governance Standards, 303A.07 Audit Committee Additional Requirements (b).

(50) The committee's purpose, at minimum, must be to (A) assist board oversight of (1) the integrity of the listed company's financial statements, (2) the listed company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the listed company's internal audit function and independent auditors; (B) prepare the disclosure required.

in writing their purpose, duties, and responsibilities as well as an annual performance review of the committees' activities. This has the benefit of making the specific details relating to the audit committee of each company known and ensure that companies give specific attention to these criteria.

In addition to providing clarity on the duties and responsibilities entrusted to the committee, it also will ensure that there is no conflict of interest and or disputes relating to the management of the company. Each director will understand what is expected of him, and what the audit committee can and cannot do.

Publishing this on their website will also ensure that shareholders, management, and other interested parties will have access to this information. This will increase the transparency of the company.

5. Comparison of the Audit Committee in Kuwait and the USA

This section will discuss the similarities and differences between audit committees in Kuwait and the USA. Corporate governance is a new development in Kuwaiti financial markets. Until recently, the principle of having an audit committee was uncertain. Without proper regulation and legislation, there was widespread controversy about this subject.

In line with international corporate governance principles, the board of directors should always have an audit committee to ensure the smooth and proper functioning of the company. An audit committee plays an active role in the internal monitoring system of a company. To increase the effectiveness of the internal control mechanisms, companies should enhance the audit committee's effectiveness.

One of the important functions of an audit committee is to show the true picture of a company to potential investors and stakeholders, as sometimes directors and/or management conceal the true state of affairs. The audit committee members will be able to enhance board efficiency only if they are truly independent and knowledgeable without being influenced by the company's management or major shareholders. The importance of an audit committee as a governance mechanism is that it is used to protect shareholders' interests and to safeguard managerial employment contracts. This is recognized worldwide.

Both the Kuwaiti and USA legal systems agree on the importance of audit committees and include it as one of the fundamental corporate governance principles. However, the concept is still fairly new in Kuwait and the understanding and application of it by companies and regulatory authorities needs to improve. For specific suggestions on how this can be done, see paragraph 6 below.

One of the main differences between the audit committees in Kuwait and the USA is the purpose of the committees. In Kuwait, the focus of the audit committee is on ensuring the integrity of the audit report, whereas in the USA, the audit committee has as one of its main purposes ensuring that there is no undue influence on the external auditor or the audit process.

Another difference between the approaches of the two countries relates to the members of the audit committee. Whilst both countries require committees to have three members with at least one being an independent director, as mentioned above the definition of independence is different. Both countries require members to have relevant skills, especially financial management skills, but in addition, the USA requires a diversity of members, which is not required in Kuwait.

With regards to meetings of the audit committee and other entities, both countries suggest that the committee meets with the external auditor, internal auditor, and board members. However, the USA sets the additional criterion that these meetings should be held separately from one another.

Another area where the countries of Kuwait and the USA differ is the definition of the duties and responsibilities of the audit committee. In the USA, these are clearly set out with no ambiguity. However, in Kuwait, the duties and responsibilities are described in general terms and need review. For suggestions on this, see paragraph 6 below.

The power and authority of audit committees in the USA and in Kuwait differ slightly. In the USA, committees are entrusted with more authority than their counterparts in Kuwait, especially in areas such as issuing press releases. Kuwait’s corporate governance needs to improve in this area to ensure those audit committees are empowered to carry out their duties and responsibilities.

Finally, the main area of difference between audit committees in Kuwait and the USA pertains to the written charter. As mentioned above, this charter is a requirement for companies listed on the NYSE and sets out clearly the authority, rights, duties, and responsibilities of the committee. It is suggested that Kuwait adopt provisions similar to those in the USA and make provision for written charters to be included in audit committees. This will have the effect of greater clarity and transparency for Kuwaiti firms.

6. Suggestions for Improving the Kuwaiti Code

This section will have suggestions for improving the Kuwaiti Code, based on studies of audit committees in the USA. The following suggestions are made with a view to improving the KCGC:

- **Clear Definition of the Audit Committee:**

The KCGC should add a clear definition of “an audit committee.” Previously, the KCGC took a formalistic approach when defining an audit committee. However, a clear definition of what constitutes an audit committee would greatly assist companies and regulatory bodies.

- **Setting out Details of What Skills are Required:**

Having members with the appropriate and relevant skills on the audit committee is vitally important. The Code should be amended to set out more details of what skills and/or academic qualifications audit committee members should have.

In order to improve the Kuwaiti Code, it has been suggested that an effort be made to refer to the diversity of skills that members of audit committees should have. Diversity in the background, skills, and experience of the members of the audit committee has the potential to enhance a committee’s effectiveness by providing a wide range of perspectives and knowledge that will assist in overseeing the company’s performance, strategy, and risk aversion(51).

- **Determining the authority and powers of audit committees:**

The KCGC should be more specific when stating who or what authority has the power to determine an audit committee’s responsibility. Clarity on the power and authority of the committee will help reduce any conflicts and problems between the board and the committee.

- **Inclusion of provisions relating to a written charter:**

On the NYSE, a listed company has to apply the audit committee charter and include a standing committee of the board of directors to set out the committee’s purpose, mission, authority, policies, and procedures, as well as any other terms of operation. The KCGC should incorporate similar provisions to ensure that these committees and the charter become a part of the corporate governance regime.

(51) I. Ferreira, *The Effect of Audit Committee Composition and Structure on the Performance of Audit Committees*, Meditari Accountancy Research, Vol. 16 No. 2, (2008), pp. 89-106. https://doi.org/10.1108/10222529200800014

- **Members expertise:**

The KCGC should require that at least one of the audit committee members be a financial expert, as this knowledge will help the committee function in a proper and more efficient way.

- **Communication with the board:**

The audit committee should inform other board members on the understanding of the financial statements, financial statements risks, and internal controls. This is key for corporate governance.

- **Diversity of skills:**

The KCGC should be amended to include clauses setting out the requirements for diversity and skills of the members of the audit committee because diversity in the backgrounds, skills, and experience will enhance a committee's effectiveness by providing a wider range of perspectives and knowledge to oversee company performance, strategies, and risks.

- **Greater flexibility regarding establishing audit committees:**

In Kuwait, an audit committee is compulsory for listed companies. However, there should be more flexibility with regard to establishing an audit committee. The listed company should have the option to create an audit committee voluntarily. Since it is still a fairly new concept in Kuwaiti corporate governance, the government should allow time for companies to apply the concept voluntarily. In time, the rules relating to an audit committee can be made compulsory along with any necessary penalties that may become applicable.

Rule V (Apply Sound Systems of Risk Management and Internal Audit) To give companies greater flexibility, it would be preferable to change this article. It is recommended that Rule V of Article (5-5) should be changed to allow companies to make decisions without any pressure relating to the establishment of the audit committee.

7. Conclusion

This article has set out the laws and regulations pertaining to the audit committee in Kuwait and the USA. It has highlighted the similarities as well as the differences between the approaches of the counties toward the principles of corporate governance.

7.1. Results

As can be seen from the information set out above, the establishment of audit committees is essential for the application of good corporate governance. The position in the USA has led to tighter controls on the board of directors and made compliance with the regulation's mandatory.

Whilst the establishment of an audit committee in Kuwait is compulsory for listed companies, the article has shown that compliance with all the regulations is onerous and has the potential consequence of companies choosing not to list on the stock exchange.

The article therefore makes the case that there should be more flexibility with regard to establishing an audit committee. It was found that listed companies should have the option to create an audit committee voluntarily. Since it is still a fairly new concept in Kuwaiti corporate governance, the government should allow time for companies to apply the concept voluntarily.

7.2. Recommendations

The following suggestions are made with a view to improving the KCGC:

7.2.1. The legislator should amend the KCGC to include a clear definition of an audit committee. A clear definition should include information on how to form an audit committee, who should sit on the committee and what its roles and responsibilities are. This would allow companies to comply with the regulations and would benefit the CMA with regards to educating companies on the need for an audit committee. It would also assist the CMA in its role of enforcing the application of good corporate governance practices.

7.2.2. The code should be amended to describe in detail what skills are required of directors assigned to the audit committee. This should include any specific skills and/or academic qualifications that audit committee members should have. Furthermore, the requirements should allow for diversity in the backgrounds, skills, and experience of the committee will enhance its effectiveness by providing a wider range of perspectives and knowledge to oversee company performance, strategies, and risks.

7.2.3. The legislator should be more specific when stating what regulatory authority has the power to determine an audit committee's responsibility. Clarity on the power and authority of the committee will help reduce any conflicts and problems between the board and the committee.

7.2.4. The regulations relating to the establishment of an audit committee should be amended by the legislator to enable companies to establish such a committee voluntarily. This will encourage compliance rather than enforce through legislation.

Further studies should be undertaken of other committees and their effectiveness in corporate governance policies with a view to potentially amending the KCGC and improving corporate governance in Kuwait. The above suggestions should not be seen as the only potential changes or improvements needed in the KCGC. Further studies and comparisons with other international stock exchanges may bring further ideas to light.

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